October 31, 2011

Via electronic submission:
Notice.Comments@IRSCounsel.Treas.gov

Internal Revenue Service
Room 5203
P.O. Box 7604, Ben Franklin Station
Washington, DC 20044

RE: Formal questions and recommendations pertaining to portability of transfer
tax exemptions between spouses embodied in Internal Revenue Code Sections
2010(c)(2) – (6)

The following comments are submitted on behalf of the American Bar Association
Section of Real Property, Trust and Estate Law in response to the matter referenced
above. These comments have not been approved by the House of Delegates or the
Board of Governors of the American Bar Association and should not be construed as
representing the position of the American Bar Association.

These comments were prepared by members of the Estate and Gift Tax Committee of
the Income and Transfer Tax Planning Group of the Trust and Estate Division of
the Section of Real Property, Trust and Estate Law of the American Bar Association.
If you have any questions, please feel free to contact any of the committee members
listed below:

Tracy Blake DeVlieger, Committee Vice-Chair, (484)683-2617
Richard S. Franklin, Committee Co-Chair, (202)857-3434
Lester B. Law, Committee Vice-Chair, (239)254-3206

Although the members of the Section who prepared these comments have clients who
would be affected by the Federal tax principles addressed, or have advised clients on
the application of such principles, no such member (or the firm or organization to
which such member belongs) has been engaged by a client to make a submission with
respect to, or otherwise influence the development or the outcome of, the specific
subject matter of these comments. Section members, including the authors, are
interested in the way that these rules affect the way they manage their practices and
business units.

We hope that these comments, recommendations and formal questions will provide a
basis for regulatory guidance to address the points for clarification identified in this
submission for the proper implementation of portability. Regulatory guidance is specifically required of Treasury in Code § 2010(c)(6).

Very truly yours,

Andrew F. Palmieri  
Section Chair

cc: Tina Portuondo, RPTE Section Chair-Elect  
Gideon Rothschild, RPTE Section Vice Chair, Trust & Estate Division  
Cara Lee T. Neville, Secretary, American Bar Association  
Thomas M. Susman, Governmental Affairs, American Bar Association
AMERICAN BAR ASSOCIATION
SECTION OF REAL PROPERTY, TRUST AND ESTATE LAW
INCOME AND TRANSFER TAX GROUP
ESTATE AND GIFT TAX COMMITTEE
COMMENTS CONCERNING PORTABILITY

FORMAL QUESTIONS AND COMMENTS CONCERNING INTERNAL REVENUE
CODE SECTION 2010(c)(2) – (6)

EXECUTIVE SUMMARY

I. GENESIS OF COMMENTS AND FORMAL QUESTIONS

The following comments, formal questions and recommendations pertaining to portability of transfer tax exemptions between spouses embodied in Internal Revenue Code Sections 2010(c)(2) – (6) are submitted on behalf of the American Bar Association Section of Real Property, Trust and Estate Law. These questions and observations have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

The questions and observations were prepared by members of the Estate and Gift Tax Committee of the Income and Transfer Tax Planning Group of the Section of Real Property, Trust and Estate Law (the “Section”) of the American Bar Association. Richard S. Franklin, Tracy Blake DeVlieger and Lester B. Law prepared these questions and observations. These comments were reviewed by Jonathan G. Blattmachr on behalf of the Section’s Committee on Government Submissions.

If you have any questions, please feel free to contact any of the persons listed below:

Contact persons: Phone Numbers:
Tracy Blake DeVlieger (484)683-2617
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Although the members of the Section who prepared these comments have clients who would be affected by the Federal tax principles addressed, or have advised

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1 All references to the Internal Revenue Code shall be to the Internal Revenue Code of 1986, as such Code may have been amended through the date of these comments. Generally, references to “sections”, “§§”, “section”, or “§” shall be references to the particular section or sections of the Internal Revenue Code, unless otherwise provided in the context of the commentary. To distinguish between a reference to the Internal Revenue Code section and another provision, sometimes reference will be to “IRC §” or “Code §” as the case may be. IRC §§2010(c)(2) – (6) were recently enacted as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (“TRA 2010”).
clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a submission with respect to, or otherwise influence the development or the outcome of, the specific subject matter of these comments. Section members, including the authors, are interested in the way that these rules affect the way they manage their practices and business units.

We hope that these comments, recommendations and formal questions will provide a basis for regulatory guidance to address the points for clarification identified in this submission for the proper implementation of portability. Regulatory guidance is specifically required of Treasury in Code § 2010(c)(6).

II. BACKGROUND AND INTENT OF COMMENTS

These comments are intended to facilitate collaboration in the resolution of these issues. With this purpose in mind, we ask Treasury to consider the following analysis and questions. We appreciate the opportunity to comment and would be happy to discuss our comments in any format you would find useful.

III. LEGISLATIVE HISTORY

Portability of the first-to-die spouse’s unused estate tax exclusion to a surviving spouse was recommended in the 2004 Report on Reform of Federal Wealth Transfer Taxes of the Task Force on Federal Wealth Transfer Taxes. The Task Force recommendation sparked various legislative proposals, and a degree of consensus emerged for the proposition that portability promotes the federal tax policies of (1) simplifying estate planning for middle class married individuals and (2) treating married individuals as an economic unit, consistent with the Internal Revenue Code provisions for gift-splitting, the unlimited marital gift and estate tax deduction, and joint income tax returns. The consensus for the general concept of portability was accompanied by a debate among Task Force participants and members of Congress concerning appropriate limitations and administrative efficiency.

The General Explanation of the Administration’s Fiscal Year 2012 Revenue Proposals issued by the Department of Treasury (commonly called the “2012 Greenbook”) states that, without portability, married couples would be required to retitle assets into each spouse’s separate name and use a trust structure in order to allow the first spouse to die to take full advantage of his or her exclusion while providing for the surviving spouse to benefit from all of the property of the spouse.

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dying first. The 2012 Greenbook further states that portability is intended to “obviate the need for such burdensome planning.”

By its terms, TRA 2010 will sunset at the end of 2012, and the availability of portability will expire. In the 2012 Greenbook, President Obama proposes to make portability a permanent fixture of our transfer tax system. We support portability of gift and estate tax exclusions between spouses as embodied in this legislation as well as the President’s proposal for permanence.

IV. DEFINITIONS

In an effort to proceed accurately and concisely, we define the operative terms and set forth our understanding of how portability was intended to work.

A. The Applicable Credit Amount

i. For Estate Tax Purposes

• Code § 2010(c)(1) sets forth the definition of the applicable credit amount, which is defined as an amount equal to a hypothetical tentative federal estate tax (determined under Code § 2001(c)) calculated on a tax base equal to the applicable exclusion amount (“AEA”).

• Code § 2010(c)(2) defines the AEA for estate tax purposes as the combination of (a) the basic exclusion amount (“BEA”) and (b) in the case of a surviving spouse, the deceased spousal unused exclusion amount (“DSUEA”).

• Code § 2010(c)(3) defines the BEA as $5,000,000 for 2011. For years following 2011, the $5 million amount is increased by a cost-of-living index factor (with a base year of 2010 adjusted in accordance with Code § 1(f)(3) in multiples of $10,000). Recall that portability ends on December 31, 2012.5

• Code § 2010(c)(4) defines DSUEA (with respect to the surviving spouse of a deceased spouse) as the lesser of (a) the BEA at the time of the death of the surviving spouse, and (b) the excess of (i) the BEA of the last deceased spouse of the decedent at the time of such last deceased spouse’s death, over (ii) the amount that was used to determine the tentative tax for estate tax purposes of such last deceased spouse (such tentative tax determined at that time under § 2001(b)(1)). Stated a bit differently, DSUEA (with respect to a decedent) is the lesser of (a) that decedent’s BEA (at the time of his or her

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4 General Explanations of the Administration’s Fiscal Year 2012 Revenue Proposals, p. 123.
5 See, TRA 2010 § 303(c) which provides for portability to begin in 2011, and see TRA 2010 § 304 which provides that portability will end on December 31, 2012. Effectively, TRA 2010 § 304 amended § 901 of the Economic Growth and Tax Relief Reconciliation Act of 2001 by changing the operative date from December 31, 2010 to December 31, 2012.
death), or (b) any unused exemption of the last pre-deceased spouse (at the
time of his or her death).

• In order for a surviving spouse to take advantage of a DSUEA, Code §
2010(c)(5)(A) provides that the executor of the last deceased spouse’s estate
must file an election on a timely filed estate tax return. Once the election is
made it is irrevocable.

• Code § 2010(c)(5)(B) also provides that the cost of allowing the use of a
deceased spouse’s DSUEA by the surviving spouse is that the period of time
for examining the deceased spouse’s estate return is extended (for purposes
of determining the DSUEA).

• Finally, Code § 2010(c)(6) directs the Treasury Secretary to issue regulations
to provide guidance with respect to Code § 2010(c).

ii. For Gift Tax Purposes

TRA 2010 §§ 302(b)(1) and 303(b) amended Code § 2505(a)(1) to extend the
benefit of portability to gift tax for 2011 and 2012. Specifically, Code § 2505(a)(1)
states that the gift tax credit for a particular year is equal to the estate tax credit
determined under Code § 2010, assuming that the donor had hypothetically died at
the end of that particular year.

V. CONCERNS and SUGGESTIONS

A. Calculating DSUEA

i. For Estate Tax Purposes

Code § 2010(c)(4) defines and limits DSUEA to the lesser of: (A) the surviving
spouse decedent’s BEA; or (B) the last predeceased spouse’s unused exemption
amount at the time of such last predeceased spouse’s death (the “DSUEA Limit”).

ii. For Gift Tax Purposes

Until December 31, 2012, Code § 2505(a)(1) refers to Code § 2010(c) to determine
the credit against gift tax (i.e., to determine one’s applicable exclusion amount for
gift tax purposes). It incorporates the concept of using the applicable credit amount
that would apply “as if” the donor died as of the end of the calendar year, and it
takes into account the amounts allowed as a credit in prior calendar years. Further,
Code § 2505(a)(2) provides that the rate tables in effect for the year of the current
gift shall be used in calculating the use of the prior taxable gifts, instead of using the
rate schedule(s) in effect at the time the prior gift(s) was (were) made.
Code § 2010(c)(4) does not accurately take into account the possibility of gifts in excess of the applicable exclusion amount (on which gift tax has been paid) in calculating DSUEA in a later year when the applicable exclusion amount is higher.

For Example: Husband makes $2.75 million of taxable gifts in 2010, using $1 million of gift tax applicable exclusion, followed by death in 2011 with a taxable estate of zero. By reducing H’s basic exclusion amount ($5 million) by the “amount with respect to which the tentative tax is determined under § 2001(b)(1)” [taxable estate plus adjusted taxable gifts, $2.75 million in this example], H has only a DSUEA of $2.25 million rather than a DSUEA of $4 million. We believe that any such result was not intended and should be remedied. One possible regulatory clarification would be to provide that the tentative tax base for purposes of Code § 2010(c)(4)(B)(ii) includes only adjusted taxable gifts upon which no tax was paid by reason of the use of the donor’s gift tax applicable exclusion (or any DSUEA of the donor’s predeceased spouse).

B. Possible Error in the Joint Committee’s Example 3

Recently, the Joint Committee on Taxation published two documents regarding portability. One was published last year in JCX-55-10, and the other, an errata statement, was published this year in JCX-20-11. Both documents are now incorporated into the Joint Committee’s General Explanation of Tax Legislation Enacted in the 111th Congress, JCS-2-11.

In JCX-55-10, the Joint Committee explained the portability provision and then provided examples to help to explain the provision. Examples 1 and 2 in JCX-55-10 are, in our view, consistent with the statute. However, Example 3 (of that same document) seems inconsistent with the current statute. Example 3 in JCX-55-10 is strikingly similar to Example 3 in the Joint Committee Report entitled “Taxation of Wealth Transfers Within a Family: A Discussion of Selected Areas for Possible Reform” (“JCX-23-08”). However, JCX-23-08 addressed previous proposed legislation (H.R. 5970) which provided that DSUEA was calculated with reference to the excess of the deceased spouse’s applicable exclusion amount over the tentative tax base in the deceased spouse’s estate.

In fact, the Joint Committee realized this inconsistency and issued an errata statement (published in JCX-20-11), which states:

“A technical correction may be necessary to replace the reference to the basic exclusion amount of the last deceased spouse of the surviving spouse with a reference to the applicable exclusion amount of such last deceased spouse, so that the statute reflects intent. Applicable exclusion amount is defined in section 2010(c)(2), as amended by the provision. [Emphasis added]”

Unfortunately, the Joint Committee’s Example 3 and errata statement leave taxpayers in a quandary: How do taxpayers and their advisors deal with an example
purporting to explain existing law, which instead explains that the example highlights a technical correction which may be reflected in future legislation? We believe that the Service should provide that no taxpayer will be penalized by reason of following Example 3 or the result that we think Congress intended (as reflected in the errata statement). In any case, we respectfully request regulatory clarification to resolve this issue. Indeed, we believe that section 2010 (c)(6) authorizes Treasury to issue regulations reflecting Congressional intent even if a literal reading of the statute supports a contrary interpretation. See *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694.

C. Using DSUEA for Lifetime Gifts - Possible “Clawback” or “Recapture”

The scheduled sunset of TRA 2010 and the possible reversion to pre-EGTRRA rules in 2013 create a scenario whereby it is entirely possible that the current gift tax applicable exclusion amount could exceed the estate tax applicable exclusion amount at the time of the donor’s death. As a result of this, and as a result of the way the current Forms 706 and 709 are written, it is possible that taxable gifts may be “recaptured” and essentially added to the taxable estate for estate tax purposes. This is because for purposes of the Tax Computation on Form 706, lifetime gifts increase the tentative tax base with an accompanying credit for gift tax payable, but the gift tax payable reduction is based on tax rates in effect at death calculated on the basis of the applicable credit at the time of the gift. The “recapture” and “clawback” risks are an unfortunate by-product of TRA 2010. If A, a taxpayer who has previously made no taxable gifts, makes a $5 million gift in 2011 (or $10 million with the use of a DSUEA), A is doing what Congress specifically allowed. If A dies in 2013 with a taxable estate of $1 million, when the estate tax exclusion is scheduled to be $1 million, the effect of adding in the $5 million of adjusted taxable gifts without preserving their exclusion from the tax base, would be to create a trap for the unwary.  

6 For example, assume A, a taxpayer who has previously made no taxable gifts, makes a $5 million gift in 2011, which is protected from gift tax by A’s $5 million gift tax exclusion amount. Thereafter, the current law does not permit any federal gift or estate tax to ever be imposed on this same gift. If A dies in 2013 with a taxable estate of $1 million, when the estate tax exclusion is scheduled to be $1 million, adding the prior $5 million of adjusted taxable gifts can in effect only increase the estate tax on the $1 million taxable estate. This is because the estate tax is imposed on the “taxable estate” as provided in Code § 2001(a), which does not include prior taxable gifts (unless included by one of the string provisions, such as Code § 2036). In this example, A’s estate could be liable for estate taxes in excess of the value of the taxable estate. Such tax would have an effective rate as to the taxable estate far in excess of the maximum rate provided in Code § 2001(c). There is neither precedent nor justification for subjecting the taxable estate to a rate of tax in excess of the highest rate of tax imposed under Code § 2001(c). The purpose of the Code § 2001(b) computation is to count the prior use of applicable exclusion through lifetime gifts in determining the proper rate bracket for transfers at death (i.e., to prevent two bracket runs). In its analysis of the purpose for the “tentative tax,” the Tax Court in *Estate of Frederick R. Smith v. Commissioner*, 94 TC 872 (1990) noted that “by [the unification of the estate and gift taxes], Congress meant to ‘reduce the disparity of treatment between lifetime and death-time transfers.’” *Smith* at 876. Judge Wells’s dissent carries this further by stating that “[t]he purpose of adding post-1976 gifts to the taxable estate and then subtracting the gift tax
The possibility of recapture is compounded in the case of lifetime gifts using DSUEA: First, the computation of the applicable exclusion amount may change dramatically between the time of the gift and the time of death because the basic exclusion amount is reduced. Second, the DSUEA component of the applicable exclusion amount may be reduced for gift tax purposes if the last deceased spouse at the time of a gift is displaced because of the death of a subsequent spouse prior to the end of the calendar year of the gift. Finally, even if the last deceased spouse does not change before the end of the year, the surviving spouse’s applicable exclusion amount may decrease for estate tax purposes if such surviving spouse remarries in a subsequent year and the second spouse predeceases such surviving spouse, and the result could be to generate a later estate tax on a tax base increased by adjusted taxable gifts which were covered by the applicable exclusion amount at the time they were made.

We respectfully request that you issue guidance indicating the Service’s positions with respect to these recapture issues. Examples would be helpful to highlight the issues and thus alert taxpayers to the results the Service believes are applicable.

D. DSUEA of a Non-Resident Alien

Under the current statute, it is unclear whether a Non-Resident Alien (“NRA”) could create DSUEA and the effect of treaty provisions. It is unclear if it is possible for a NRA to create DSUEA; or how it would be calculated. The Code provides a Non-Resident Alien (“NRA”) with a $13,000 unified credit pursuant to Code § 2102(b)(1). Because the NRA does not have an applicable exclusion amount or a basic exclusion amount, it seems at first blush as if NRA’s can neither give nor receive the benefit of a DSUEA. However, Code § 2102(b)(3)(A) provides that a higher credit (which bears the same ratio to the Code § 2010(c) credit amount as the portion of the gross estate situated in the U.S. bears to the total gross estate) will be allowed to a NRA to the extent a treaty obligation of the U.S. so requires. Canada, for example, has such a treaty. Because DSUEA is tied to the applicable credit, the NRA surviving spouse payable on those gifts is to “push the taxable estate up to its ‘proper’ place on the unified cumulative rate schedule.” Smith at 882-3, citing Bittker, Federal Taxation of Income, Estates and Gifts, ¶133.3.2 (1972). The estate tax laws are not designed to recapture gift taxes which were not applicable to the gifts when they were made, and there is nothing in the statute or legislative history to indicate that Congress ever intended such a result.

7 The Service should consider providing examples in reference to gifts that explain the application of the “last such deceased spouse” under Code § 2010(c)(4)(B)(i). The statute appears to clearly allow the use a former deceased spouse’s exemption prior to the death of a future deceased spouse. By allowing the use of a last deceased spouse’s DSUEA before the death of a subsequent spouse, the possible inadvertent forfeiture of a tax benefit intended for the original married couple is avoided.

8 The Service could provide that Code § 2505(a)(1) should be interpreted such that each gift is separately evaluated to determine the amount of one’s applicable exclusion amount at the time of such gift. Even though it is presumed that the donor died at the end of the year, an intervening subsequent spouse’s death should be ignored with regard to the gift and use of a prior spouse’s DSUEA.

9 Regulations taking an approach parallel to that discussed in footnote 8 might avoid this result.
may be able to include DSUEA of a predeceased NRA spouse in his or her credit amount if an appropriate election has been made. A U.S. citizen surviving spouse would have a more difficult time justifying DSUEA derived from a NRA spouse because the treaty does not operate to define the rights of the U.S. citizen spouse. If the DSUEA is allowable and can be calculated, is there a mechanism under the Form 706-NA to allow for the election? Guidance on this issue is respectfully requested.

E. Determination of DSUEA After Application of Other Estate Tax Credits.

We believe the regulations should provide that the amount of DSUEA is determined after the application of all other estate tax credits allowed under the Code. We respectfully request the Service’s guidance on this.

F. Hierarchy of Use of DSUEA.

One of the issues that the planner faces when advising clients is how much of the client’s applicable exclusion amount (AEA) should be used when making a taxable gift. Since DSUEA and the client’s own BEA are separate components of AEA, a question arises: “When is DSUEA used?” On its face, Code §2010(c) is silent with regard to the hierarchy of the surviving spouse’s use of each component of AEA. In applying Code § 2010(c)(4), it appears that without clarification, the end result is that a surviving spouse’s BEA is always used first, and that DSUEA may be forfeited in certain circumstances. The next question is whether this was Congress’ intent?

The American College of Trust and Estate Counsel (ACTEC) believes that Code § 2010(c)(4) as drafted does not reflect the intent of Congress, and further that an ordering rule is unnecessary to intended design and operation of the statutory structure. In their analysis, ACTEC argues that read literally, the statutory DSUEA calculation permits a surviving spouse an AEA consisting of his or her own BEA augmented by the lesser of two amounts:

1) the basic exclusion amount; and
2) the basic exclusion amount of the predeceased spouse reduced by the predeceased spouse’s tax base (i.e., the sum of the predeceased spouse’s taxable estate and adjusted taxable gifts).

Because the second amount cannot be greater than the first amount, the statute does not make sense on its face. Examination of the legislation and its history supports the conclusion that Congress did not have a specific intention to so restrict DSUEA. As Example 3 in the Joint Committee Report indicates, and as confirmed by the Staff of the Joint Committee on Taxation in the Errata statement, Congress

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10 We recognize that it is possible that the amount under Code § 2010(c)(4)(B) could be more than that under Code § 2010(c)(4)(A) if Congress legislatively reduces the amount of BEA. We do not believe, however, that that possibility accounts for the current statutory framework.
intended the second amount to be equal to the "applicable exclusion amount," not the basic exclusion amount, reduced by the predeceased spouse’s tax base. When read as intended by Congress, the absurdity disappears. The applicable credit amount, reduced as stated Code § 2010(c)(4)(B), might indeed be greater than the basic exclusion amount, and this interpretation gives Code § 2010(c)(4)(A) significance where it would otherwise be irrelevant.

ACTEC correctly points out that it is fundamental to the task of statutory construction that courts may ignore a literal reading of a statute in order to avoid an absurd result.11 Moreover, courts may cure a scrivener’s error contained in a statute.12 Because a court would construe Code § 2010(c)(4) in accordance with Congress’ intent, Treasury should be able to achieve the same result by regulation.13 The first inquiry under Chevron14 is whether the proposed regulation is foreclosed because it is contrary to an unambiguous statute. The use of overlapping verbiage without any indication in the legislative history of an intention of purpose does not evidence a specific intent to impose the literal restriction. On the contrary, the legislative history of Congress’ intent and the Errata suggest the opposite. At the very least, the statute is ambiguous, and the Treasury has the duty and the authority under Chevron to resolve it in accordance with Congress’ intent. In addition, it should be noted that, under Code § 2010(c)(6), the Treasury is expressly given the authority "to prescribe such regulations as may be necessary or appropriate to carry out this subsection."15 On these grounds, and because the suggested clarifying regulation could not, and would not, be challenged by a taxpayer, ACTEC has respectfully suggested that the regulations correct the literal and nonsensical statutory language by substituting “applicable” for “basic” in Code § 2010(c)(4)(B)(i).

We believe in the soundness of ACTEC’s analysis and support a regulation recognizing the correction proposed by the Joint Committee’s Errata. In the absence of such a correction, the Joint Committee’s Example 3 suggests that the DSUEA component of AEA is used first, but this interpretation also requires a regulation clarifying the statutory language.16

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14 U. S. A. Inc. v. Natural Resources Defense Council, Inc., 467 U. S. 837. The first step of the Chevron test is whether Congress has “directly addressed the precise question at issue.”
15 See, Mayo Foundation for Medical Educ. and Research v. U.S., 107 AFTR 2d 2011-341, 131 S. Ct. 704 (2011) (applying Chevron to an interpretive tax regulation issued under Code § 7805 and indicating that such a regulation should receive no less deference than a specific-grant regulation). See also, Rowan Cos., v. U.S., 452 U.S. 247, and U.S. v. Vogel Fertilizer, Co., 455 U.S. 16, where the Courts provide that greater weight is given to the Treasury’s regulations when there is a specific grant of authority under a statute(versus the general grant of authority under Code §7805(a).
16 To the extent that the Treasury does not adopt ACTEC’s approach, then it is arguable that the determination of the order of exclusion utilization has definitive implications. The issue in this part of our analysis focuses on “how much” DSUEA is utilized when a surviving spouse makes a taxable
G. Election Requirement.

Code § 2010(c)(5)(A) provides as follows:

“Election required. A deceased spousal unused exclusion amount may not be taken into account by a surviving spouse under paragraph (2) unless the executor of the estate of the deceased spouse files an estate tax return on which such amount is computed and makes an election on such return that such amount may be so taken into account. Such election, once made, shall be irrevocable. No election may be made under this subparagraph if such return is filed after the time prescribed by law (including extensions) for filing such return.”

To take advantage of DSUEA, the statute requires three steps:

- File a timely and complete estate tax return;
- Compute DSUEA; and
- Elect portability.

The Service recently issued in final form the United States Estate (and Generation-Skipping Tranfer) Tax Return for decedents dying after December 31, 2010 and gift. It is important to understand that if the BEA is used first, then it reduces the potential DSUEA that the surviving spouse could convey, if he or she remarried. If the DSUEA is used first, then it preserves the BEA for a future spouse and reduces the likelihood of recapture, discussed supra, in the text accompanying notes 7 and 8. In the absence of statutory authority, in light of definite regulatory authority provided under Code § 2010(c)(6), we believe that the Service could provide regulatory guidance and adopt one of three possible approaches:

- **Use DSUEA First Approach:** The Service could provide that if a taxable gift is made, then the DSUEA available at the time of the gift is used first until it is fully expended. Also, they would have to provide that the surviving spouse does not lose the benefit of their own BEA upon death or for future gifts.

- **Use DSUEA Last Approach:** The Service could provide that if a taxable gift is made, the donor must use his or her BEA first and after it is fully expended, he or she may use any available DSUEA.

- **Proportionate Use of DSUEA and BEA:** The Service could use an alternate approach so that the DSUEA and BEA are used proportionally. If DSUEA could change during the remainder of the calendar year after the date of the gift, perhaps the proportion should be evaluated at the end of the year “as if” the donor dies at the end of such year.

In providing guidance on an approach, Treasury should also provide that if a surviving spouse used the DSUEA of a first deceased spouse, and the survivor remarries and survives the second spouse, the benefit of the first deceased spouse’s DSUEA will not be lost as a result of the death of the second spouse.
before January 1, 2011 (the "2011 Form 706"), and the instructions for such return. We applaud the Service’s development of an elective approach to portability that can be completed with a minimum of steps and little complication.

We note at the outset that the second requirement of computing the DSUEA is not satisfied in the draft form, unless the statute is interpreted by regulation to require merely that the return that is filed provide a sufficient basis to compute DSUEA. It appears to us that Code § 2010(c)(5)(A) as enacted requires the executor of the “last deceased spouse,” the one making the portability election, to compute the DSUEA. The form should provide for this step or regulations should clarify that the foundational data is sufficient. Without clarification, practitioners will be unsure of how to make an effective and complete return as required for the election.

i. Instructions to Form 706

1. Attach Predeceased Spouse’s 706

Page 13 of the instructions, Part 4 – Line 3 instructs the executor, in part, as follows:

“... Also, if the prior marriage ended in death and the predeceased spouse died after December 31, 2010, indicate on the Explanation line whether the executor of the estate of the predeceased spouse elected to allow the decedent to use the deceased spouse’s unused exclusion amount. If the executor of the predeceased spouse’s estate made the election, attach to the return the predeceased spouse’s Form 706 and a calculation of the deceased spousal unused exclusion amount (DSUE amount). For more information, see section 2010(c)(4).

For estates of decedents dying in 2011, the DSUE amount equals lesser of:

1. The basic exclusion amount of $5,000,000, or
2. The basic exclusion amount of the decedent’s $5,000,000, MINUS the amount in line 5, Part 2—Tax Computation, of the last predeceased spouse’s Form 706 (but not below zero).

Note. The election to use the DSUE amount applies to the most recent predeceased spouse of the decedent.”

As the Service is well aware, estate tax returns could be quite voluminous. It is not clear from these instructions whether the predeceased spouse’s entire return must

to be attached with all schedules and accompanying documentation. We suggest that simply requesting the attachment of pages 1 and 2 of the predeceased spouse's Form 706 would be more precise in instruction and would be less likely to inundate the Service with useless paper. These two pages should provide the Service with the requested information, and presumably the Service has access in its own records to the full copy of the predeceased spouse's Form 706 if more information is needed (or it could be requested the full form from the executor of the surviving spouse's estate). Below we suggest that the Service develop a universal gift/estate tax DSUEA schedule to compute and track the DSUEA, which also could be included with the request to provide pages 1 and 2 of the 2011 Form 706.

ii. Form 706

1. Calculate DSUEA

As discussed above, the statute requires that the executor calculate the DSUEA and report such amount on the estate tax return of the deceased spouse. The Service might add a new line 4(d) on Part 4, page 2, asking for the deceased spouse’s DSUEA (as computed per the separate schedule recommended below). A separate DSUEA schedule might aid the executor in the calculation of the amount. We feel fairly confident that most programs that are used to prepare a Form 706, could with minor programming changes compute and automatically insert the amount in that new box.

2. Calculate Surviving Spouse’s Applicable Exclusion Amount

The surviving spouse’s unified credit equivalent to the applicable exclusion amount should be calculated and shown on the return. The Service could break line 9 on Part 2, page 1, into two lines, with the first line asking for the unified credit equivalent for the surviving spouse’s basis exclusion amount and the second line asking for the deceased spouse’s unified credit equivalent to the DSUEA (as computed per the separate schedule recommended below). The sum of these amounts would be the unified credit equivalent to the surviving spouse’s applicable exclusion amount. The DSUEA schedule would take into account the use of DSUEA by lifetime gifts.

iii. DSUEA Schedule

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18 If there were no statutory requirement to calculate the DSUEA, we would suggest that the Service allow surviving spouse to wait to calculate the DSUEA when he or she uses it during life (on the gift tax return (Form 709)), and/or the executor of the surviving spouse to calculate the DSUEA at the time of filing the surviving spouse's Form 706. The reason for this is that the estate of the surviving spouse, may or may not be able to use the DSUEA (because of remarriage or change in the law). It seems reasonable to postpone the cost of calculating the DSUEA until the surviving spouse wishes to use it either during life or at death. Interpretive regulations would be required to clarify that this approach is consistent with the statute.
We suggest that the Service develop one universal DSUEA schedule (the “DSUEA Schedule”) for use in preparing the deceased spouse’s estate tax return, and the gift and estate tax returns of the surviving spouse. Part 1 of the DSUEA Schedule could be the section applicable to the computation of the deceased spouse’s DSUEA.

Part 2 of the DSUEA Schedule could be used for gift tax purposes by the surviving spouse to track the usage of DSUEA. This section could coordinate with the gift tax return.

Part 3 of the DSUEA Schedule could be used for estate tax purposes by the surviving spouse’s executor to compute the available DSUEA and convert it to a unified credit equivalent that is reportable on the new proposed line 9(b) on the 2011 Form 706, or future estate tax returns.

Both Parts 2 and 3 would need to address the effect on the DSUEA of a subsequent change in estate tax rates or in the basic exclusion amount.

iv. Gift Tax Return (Form 709)

Similar to that described above for the 2011 Form 706, the gift tax return Form 709 requires revision to allow for the use of unified credit equivalent attributable to DSUEA. Perhaps Schedule B should be coordinated with the proposed DSUEA Schedule. On the first gift tax return filed and using DSUEA, perhaps require the attachment of pages 1 and 2 of the predeceased spouse’s Form 706 and the DSUEA Schedule. Thereafter, the DSUEA Schedule could be required for each gift tax return.

H. File a Timely and Complete Estate Tax Return

i. Treasury Reg. Section 301.9100 Relief

We believe that the Service should be clear whether Treas. Reg. § 301.9100 relief or other relief in the event of a late filing would be available. We respectfully suggest that this be covered in the regulations.

Understanding that this is new legislation, and that both taxpayers and advisors may not have accurate information about the provision, we recommend that the Service consider implementing lenient relief provisions to correct any inaccuracies, failed elections, and the like and without the imposition of penalties where the taxpayer has acted in good faith.

ii. Amended Returns

We suggest that the Service also address how an amended return would affect the election, to either:
- make a timely election on an amended return that is filed within the time limit of filing a timely estate tax return;
- make an election on an amended return that is filed after the time for filing a timely estate tax return is filed;
- “undo” an election, on an amended return that is filed within the time limit of filing a timely estate tax return; and
- “undo” an election, on an amended return that is filed after the time for filing a timely estate tax return is filed.

iii. Relief for Late Filed Returns

The statute appears to preclude relief if a late return is filed. The 2011 Form 706 also takes that position. We respectfully request that the Service review this issue and provide definitive guidance. It is our hope and belief that lack of relief in this circumstance could have a detrimental effect to taxpayers for a mere administrative error. The “punishment,” we believe, is egregious and disproportionate to the likely errors which will understandably occur. Accordingly, if the Service believes that it is able to provide guidance and provide relief, we would appreciate having the same.

The language in the instructions to the 2011 Form 706 says that “not filing a timely and complete Form 706 will effectively prohibit the surviving spouse’s use of the decedent’s unused exemption.” We would like some guidance on what is meant by a “timely and complete Form 706”. By example, will the inadvertent failure to include a supplemental page of the Form 706 be considered an “incomplete” Form 706? We suggest that simple errors like this will not be detrimental to a taxpayer.

iv. Relief for Late Election

As with the issue for “Relief for Late Filed Returns”, we would also like the Service to consider giving additional guidance (if possible) on relief for late elections (whether made on a late filed return, or on an amended return).

v. Protective Elections

Guidance on how a protective election would be very useful. By way of example, if there is a will contest, where DSUEA depends upon the prevailing party (i.e., DSUEA will be unknown), how will one be able to file the election? We suggest a protective election.

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19 The instructions to Part 4 – Line 4 (on Page 13 of the supplemental instructions, says: “Alternatively, if the filing of a Form 706 is not otherwise required for the decedent’s estate, not filing a timely and complete 706 will effectively prohibit the surviving spouse’s use of the decedent’s unused exemption.” See our discussion supra in Section V.H.vii of this letter.
We would also guidance on how to make a “protective” election, in other situations where cases where a protective election may be warranted (e.g., client does not know the value of an asset; the value of an outstanding liability; or whether the asset is owned by an estate).

vi. Effect of Spousal Agreements.

The effect of spousal agreements was not addressed in the statute. By example, if the decedent entered into a spousal agreement that the surviving spouse would be able to use the decedent spouse’s DSUEA (if any) and the personal representative, without knowledge of the agreement, failed to file the decedent spouse’s estate tax return, how would the surviving spouse be able to take advantage of the DSUEA? It is not clear under the statute.

Further, let’s assume a disagreement among the beneficiaries arises as to whether the spousal agreement is effective. Is the surviving spouse permitted to file a Form 706 to make the election, even though the surviving spouse is not the executor? Guidance on these issues is respectfully requested.

vii. If No Return Is Required to be Filed, is There a Time Limitation for Making the Election?

In cases where the decedent’s gross estate is less than the basic exclusion amount (i.e., $5 million in 2011 and $5.12 million in 2012), Code § 2010(c)(5)(A) is unclear when an estate tax return must be filed to elect portability under Code § 2010.

Code § 2010(c)(5)(A) provides that an election cannot be made if the estate tax return is filed “after the time prescribed by law (including extensions)”. Stated positively, the executor must file an estate tax return before the time prescribed by law (including extensions) expires. Code § 6018 provides that an estate tax return is required if the decedent’s gross estate exceeds the basic exclusion amount. Code § 6081 (and the Treasury’s regulations thereunder) provide that by filing a Form 4768, an estate is granted an automatic 6-month extension to file an estate tax return “required by this title or by regulations.” Code § 6075 provides that the time for filing an estate tax return (that is required to be filed) is nine months from the date of death (without taking into account any extension). There is no provision addressing extensions of time to file returns which are not required to be filed.

Technically the statute provides no “time prescribed by law” (and accordingly no “time prescribed by law (including extensions)”) for filing an estate tax return if the basic exclusion amount exceeds the value of the decedent’s gross estate. To take advantage of portability, an estate tax return must be filed within the time “prescribed by law (including extensions)”. 

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We acknowledge that under IRS Notice 2011-82 and the new filing instructions for the 2011 Form 706, the Service treats an estate that is required to file a 2011 Form 706, under Code § 6018, the same as an estate that is not required to file such return.

Since there appears to be a gap between the language in the Code and the Service's position in the above-mentioned Notice and instructions to the 2011 Form 706, in cases where the gross estate is less than the basic exclusion amount, we respectfully request regulatory clarification of “the time prescribed by law (including extensions)” for filing the 2011 Form 706 (and future estate tax returns for those dying after December 31, 2011). Additionally, if the Service believes that the time for filing the estate tax return is the same for all estates (regardless of the gross estate requirement under Code § 6018), we also respectfully request guidance on how to obtain an additional automatic 6 month extension of time in the event the executor needs and/or requests additional time.

viii. What if No Executor Was Appointed?

If no executor is appointed, will the rules under Code § 2203 apply to filing a Form 706 for making the election? Will the 'substitute’ executor be able to make the election?

I. Examination of Returns After Expiration of Statute of Limitations – Limited to Determination of Tax in Surviving Spouse’s Estate.

Code § 2010(c)(5)(B), provides that, notwithstanding the expiration of a statute of limitations set forth in Code § 6501 on an estate or gift tax assessment for a deceased spouse, the IRS may continue to examine the decedent spouse’s estate tax return for purposes of determining the DSUEA available to the surviving spouse. It is not clear from the Code that the statute of limitations remains open on this issue only so long as the Code § 6501 period with respect to the estate tax return of the surviving spouse claiming DSUEA remains open. We would appreciate clarification of this issue.

VI. CONCLUSION

Portability is potentially a very beneficial tax provision for moderately wealthy married individuals introduced into the Internal Revenue Code under TRA 2010. Currently its utility is limited because of its sunset after 2012; we are in support of President Obama’s desire to make the provision permanent. Notwithstanding the current temporary state of the law, we believe that there are some issues that should be addressed, and we believe Treasury is best equipped to clarify the issues to assist taxpayers with filings which will begin to become due in less than one month.
We have tried to avoid areas of uncertainty regarding the future direction of the law, rather we raise issues that are current and will be relevant in the event of a taxpayer’s death from now to the end of 2012. If the Congress and the Administration see fit to extend the provision (either indefinitely or again temporarily), we believe that many of these issues may persist. We look forward to your review of these comments and your response to the requests for guidance raised herein.

We appreciate your time to review the contents of this submission. We would be happy to continue to work together to address new issues which will develop as we deal with the implementation of portability.